IN THE

Supreme Court of the United States

October Term, 1977

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No. 897

YAACOV MERIDOR and MILA BRENER,

Petitioners,

—v.—

DAVID GOLDBERG suing derivatively in right and for the benefit of UNIVERSAL GAS & OIL COMPANY, INC., HENRY A. SINGER, ARA A. CAMBERE, H. STRUVE HENSEL, DAVID MERIDOR, S. ERELL, GIDEON BEN AARON, HAIM RAFAELI, JACOB SUTTON, MARTIN SIEM, MARITIMECOR, S.A., MARITIME FRUIT CARRIERS COMPANY, LTD., and UNIVERSAL GAS & OIL COMPANY, INC.,

Respondents.

77-

No. 940

HENRY A. SINGER,

Petitioner,

—v.—

DAVID GOLDBERG suing derivatively in right and for the benefit of UNIVERSAL GAS & OIL COMPANY, INC., YAACOV MERIDOR, MILA BRENER, ARA A. CAMBERE, H. STRUVE HENSEL, DAVID MERIDOR, S. ERELL, GIDEON BEN-AARON, HAIM RAFAELI, JACOB SUTTON, MARTIN SIEM, MARITIMECOR, S.A., MARITIME FRUIT CARRIERS COMPANY, LTD., and UNIVERSAL GAS & OIL COMPANY, INC.,

Respondents.

BRIEF IN OPPOSITION TO THE PETITIONS FOR WRITS OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the unanimous finding of the Court of Appeals that further amendment to the complaint should have been permitted to include reference to the two press releases or otherwise to claim deception, merits review by this Court?

2. Whether a majority of the Second Circuit Court of Appeals was correct in deciding that a cause of action exists under Section 10(b) of the Securities Exchange Act on behalf of a subsidiary when its parent causes the subsidiary to sell its securities to the parent in a fraudulent transaction and fails to make a disclosure or makes a misleading disclosure?

STATEMENT OF THE CASE

This is a derivative action, commenced by David Goldberg, a stockholder of Universal Gas & Oil Company, Inc. (UGO), a Panama corporation with its principal place of business in New York City.

The action seeks to recover damages and other relief against UGO's parent corporation, Maritimecor, S.A., also a Panama corporation, Maritimecor's parent, Maritime Fruit Carriers Company Ltd., an Israeli corporation, directors of one or more of these corporations, and an investment firm and an accounting firm. Defendants are charged with violating § 10(b) of the Securities Exchange Act and Rule 10b-5.

Goldberg's original complaint, filed on February 3, 1976, was met with a motion for a stay pending the posting of security

for costs and expenses under § 627 of the New York Business Corporation Law. The district court ruled that Goldberg had to satisfy the exemptions under the statute, or post security in an amount to be determined, or amend the complaint to delete all state law claims.

Goldberg chose to amend the complaint. The amended complaint alleges a scheme to defraud UGO beginning with the raising of public funds through an offering in May 1972. The UGO prospectus stated the proceeds would be used to finance the construction and purchase of three vessels for transporting liquified gases and that UGO's business would be transporting liquified gas. Thereafter, in 1974, UGO sold contracts for construction of two of these vessels for $25,000,000, realizing a profit of $14,000,000. At the same time UGO was selling off its assets, the cash proceeds were being used to finance

the operation of its parent, Maritimecor. Maritimecor borrowed a total of $7,000,000 from UGO throughout 1974 and up thru August 1975.

The alleged fraud culminated in an agreement in August 1975 between Maritimecor and UGO by which UGO was to issue up to 4.2. million shares of its stock to Maritimecor for all the latter's assets, except for the 2.8 million UGO shares it already owned, and all of Maritimecor's liabilities including the $7,000,000 it owed UGO. The agreement was carried out to the extent that Maritimecor transferred its assets and liabilities to UGO. The amended complaint alleges that the amount of Maritimecor's liabilities far exceeded its assets and that this transaction constituted a fraud and deception of UGO.

A motion to dismiss the amended complaint was made asserting that it failed to state a claim under §10(b) of the Securities

Exchange Act and Rule 10b-5. In opposition to the motion, an affidavit was submitted attaching two press releases issued by UGO, one in August, and the other in December 1975. These were the only press releases concerning the securities transaction between UGO and Maritimecor. Petitioners have never disputed that both of these press releases antedated the transfer of Maritimecor's assets and liabilities to UGO and that both were misleading and failed to disclose the necessary details of the transaction. Neither release made any reference to (1) the amounts of Maritimecor's assets and liabilities, (2) the fact that the $7,000,000 loaned by UGO was in effect being forgiven, and (3) the fact that Maritimecor as of the end of fiscal 1974 had current liabilities of $42.5 million. On the contrary, the two releases painted the transaction in positive terms. Goldberg charged that as

a result of this transaction UGO, which at the end of 1974 had current assets of about $41 million and current liabilities of $2 million, wound up with a net deficit of about $3.6 million of current liabilities, became insolvent, defaulted on its obligations and the value of its shares substantially decreased. Goldberg pointed out that no discovery had been permitted pending resolution of the two motions and asked for leave to amend to set forth the facts contained in the affidavit.

Judge Lasker refused to permit a further amendment of the complaint and decided that the amended complaint failed to plead deception or nondisclosure.

The Court of Appeals for the Second Circuit, on September 8, 1977, reversed. The Court unanimously held it was error to deny leave to amend as requested and then the Court with one judge dissenting,

considered the two press releases as part of the amended complaint, and held it sufficiently alleged deception and nondisclosure under Section 10(b).

PRELIMINARY STATEMENT

The Court of Appeals' opinion, permitting a further amendment of the complaint and holding that the District Court's refusal to permit such further amendment was an abuse of discretion, is consistent with the liberality accorded amendments where answers have not been served and discovery has not been held. In addition, in support of its opinion on this issue, the Court of Appeals noted that the application to replead was actually the first amendment sought to allege further facts of nondisclosure or misdisclosure.

It is further submitted that the majority opinion below, in finding a cause

of action under Section 10(b), is entirely consistent with the decisions of this Court. It follows the teachings of the most recent cases, Santa Fe Industries Inc. v. Green, 430 U.S. 462 (1977) and TSC Industries Inc. v. Northway Inc., 426 U.S. 438 (1976).

Petitioners' threatened flood of cases into the federal courts alleging corporate mismanagement "involving a parent-subsidiary transaction and a security" is unsupportable. First, the law as it exists today permits such claims in federal court as an action within Section 10(b). There has not been a "flood" of litigation and the instant case in no way increases the likelihood of such an eventuality. Second, simply because petitioners label such cases as "essentially state court claims" begs the question of whether or not this case widens the scope of cases cognizable under

Section 10(b). We submit it does not. On the contrary the majority opinion below followed a long line of cases in upholding federal jurisdiction on the facts of this case.

ARGUMENT

The Second Circuit Properly Found These Facts to Constitute the Required Deception

Petitioners first claim the Second Circuit erroneously found deception. They state at p. 8 of the Meridor-Brener petition:

> Here no deception or manipulative conduct in connection with the transaction is alleged.

This completely overlooks the two press releases which directly concern this transaction and described it so favorably. The Second Circuit found that the first, the August release, held "out an inviting picture" for UGO after the transaction. (Meridor-Brener, p.8a).*/ Goldberg, on the

*/ References are to pages in the indicated petitions.

contrary, asserts that the transaction led to UGO's doom. Both releases failed to disclose the facts of the transaction. The purpose of the transfer was not to benefit UGO, but simply to get UGO to pay its parent's liabilities out of UGO's own ample corporate funds. The Second Circuit made a specific finding at fn. 8 to its opinion that if the facts alleged by Goldberg were true, "...a disclosure of the acquisition of Maritimecor that omitted these facts would be seriously misleading." (Meridor-Brener p.19a). (Emphasis in original).*/ At no time

*/ Even the dissenting opinion, in referring to Goldberg's allegations, states:

> While these are probably sufficient to survive a motion to dismiss, they amount to little more than that. (Meridor-Brener p.27a).

have petitioners disputed Goldberg's facts or his charge that these releases were misleading and deceptive.

Petitioners further argue that because all the directors, or at least more UGO directors than were needed to vote in favor of the Maritimecor transaction, are charged with the fraud there can be no deception as a matter of law. They urge that since all the directors knew the facts alleged by Goldberg they couldn't be deceived. Reliance is placed on Santa Fe v. Green, supra at 475. But Santa Fe really has very little to do with this case. In Santa Fe it was concluded that there was full disclosure to the minority shareholders of all relevant information concerning the merger. Here Goldberg has charged the very opposite. There was a failure to disclose the facts of the transaction and such disclosure as was made was misleading. Moreover, Santa Fe deals with

disclosure to minority shareholders and this Court's only reference to deception of directors is at footnote 15 of its opinion. While this Court's only comment is that all the cases cited therein have an element of deception, it would seem that the footnote indicates approval of the Second Circuit's analysis of deception in cases where the allegation is that the entire board of directors participated in the fraud. The footnote states: "majority stockholder and board of directors 'were guilty of deceiving' the minority stockholders", citing Schoenbaum v. Firstbrook, 405 F.2d 215,220 (2nd Cir. 1968), (en banc), cert. denied, 395 U.S. 906 (1969) and quotes from Pappas v. Moss, 393 F.2d 865,869 (3rd Cir. 1968):

> "...if a 'deception' is required in the present context [of §10(b) and Rule 10b-5], it is fairly found by viewing this fraud as though the 'independent' stockholders were standing in place of the defrauded corporate entity..."

Thus, the Second Circuit's opinion follows a long line of cases supporting a derivative action under Section 10(b), even against all the directors. As the Court of Appeals stated (Meridor-Brener p. 17a):

> Schoenbaum, then, can rest solidly on the now widely recognized ground that there is deception of the corporation (in effect, of its minority shareholders) when the corporation is influenced by its controlling shareholder to engage in a transaction adverse to the corporation's interests (in effect the minority shareholders' interests) and there is nondisclosure or misleading disclosures as to the material facts of the transaction.

Moreover, the deception as charged by Goldberg, was clearly in connection with a securities sale. The corporation, UGO, was selling its stock for the transfer of Maritimecor's assets and liabilities. The deception is the failure to disclose the facts of this transaction in the two press

releases and the misdisclosure results from the inviting picture presented of the transaction. Petitioners offer no contrary authority to the Court of Appeals' view that this deception was in connection with a securities sale.*/

Thus, we submit that the law is well settled that a corporation can be deceived

*/ Admittedly Goldberg, as a minority shareholder, was neither a purchaser nor a seller and he did not have an investment decision to make for himself. We submit that misses the point made by the majority opinion below. Goldberg's sole function in the Second Circuit's alternative analysis was as protector of UGO, a seller of securities whose ability to make an investment decision was impaired by the fraud.

even though all its directors are charged with deception. This case presents no novel principals of law relating to the Court of Appeals finding of deception in connection with a securities sale, nor any decisional conflicts on that issue that require review by this Court.

The Second Circuit Properly Found This Deception Was Material

The Second Circuit majority determined that this deception was material within the meaning of Rule 10b-5. It held that the deception was material first with respect to the corporation UGO, as represented by a reasonable and disinterested director, and then, as an alternative, with respect to minority shareholders, represented by Goldberg.

The Second Circuit's majority opinion relies on TSC Industries Inc. v. Northway

Inc., supra, for the meaning of materiality (Meridor-Brener p. 20a).

> When, as in a derivative action, the deception is alleged to have been practiced on the corporation, even though all the directors were parties to it, the test must be whether the facts that were not disclosed or were misleadingly disclosed to the shareholders "would have assumed actual significance in the deliberations" of reasonable and disinterested directors or created "a substantial likelihood"that such directors would have considered the "total mix" of information available to have been "significantly altered" ...Here there is surely a significant likelihood that if a reasonable director of UGO had known the facts alleged by plaintiff rather than the bare-bones of the press releases, he would not have voted for the transaction with Maritimecor.

Petitioners take strong issue with this reasonable director analysis. But we urge that is the test invoked by TSC Industries Inc. v. Northway, Inc. supra.

As an alternative holding, the majority stated that the alleged deception was also material to Goldberg himself

because he had a remedy had he known the facts and not been misled by the two press releases (Meridor-Brener p. 20a). The question of whether or not Goldberg had a remedy was perhaps derived from this Court's footnote 14 to its Santa Fe opinion where it referred to the secondary argument raised by the minority shareholder that the lack of advance notice of the merger was a material nondisclosure under Rule 10b-5. This Court rejected the argument because there was no showing of what the shareholder could have done differently had he received advance notice. The minority shareholder had accepted the conclusion that he could not have enjoined the merger under state law. But most importantly, in rejecting the argument, this Court emphasized that there was no requirement that advance notice of the merger be given. Thus, there was nothing

inherently wrong in not giving the notice, and the burden was placed on the shareholder to show what course of action he would have taken had he received the notice. This is far different from the nondisclosure and deception by the UGO directors which are inherently wrong.

We, therefore, submit that the Second Circuit's majority opinion is entirely consistent with both this Court's holding in TSC Industries v. Northway Inc., supra and footnote 14 to the opinion in Santa Fe v. Green, supra.

The New York Security For Costs Statute is Not Applicable

Petitioners ask this Court to apply the New York security for costs statute, New York Business Corporation Law § 627, to claims under Section 10(b) and Rule 10b-5.

If this is a federal claim under 10(b)

as the majority opinion below decided, there is no valid reason why a state security for costs provision should be applied. This was squarely presented by McClure v. Borne Chem. Co., 292 F.2d 824 (3rd Cir. 1961) and this Court denied certiorari at 368 U.S. 939 (1961). Petitioners offer no valid reason why the issue should now be considered.

Petitioners' Argument That This Suit is Barred by the Law of Panama Does not Merit Review

Petitioners argue that the law of Panama controls, and that a derivative suit on behalf of a corporation is not permitted under Panama law. Hence they argue this action must be dismissed. This point was raised for the first time by petitioners on their application for re-argument to the Court of Appeals and it was rejected without opinion (Singer p. 46a). We submit that where there are United States shareholders and UGO has its principal place

of business in New York, Panama law would not be applied to defeat an action brought pursuant to a United States statute, to wit, Section 10(b) of the Securities Exchange Act. See for example, Miller v. Steinbach, 268 F.Supp. 255, 266-9 (S.D.N.Y. 1967). This Court has expressed the same view in J.I. Case Co. v. Borak, 377 U.S. 426 (1964).

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted,

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